Special Article

Five Years of Tariff-Rate Quotas— A Status Report

When the next round of World Trade Organization (WTO) agricultural trade negotiations gets under way in earnest next year in Geneva, the issue of tariff-rate quotas, or TRQ's, will likely emerge in headlines and discussions. There are now over 1,300 TRQ's applied to agricultural products, and many limit trade on key or politically sensitive commodities.

Liberalizing TRQ's worldwide can mean big opportunities for exporters and consumers, but it can also mean big adjustments for producers who benefit from TRQ protection. With the stakes high on both sides, there is considerable potential for serious disagreement.

What Are Tariff-Rate Quotas?

A TRQ is, simply, a two-tiered tariff. A limited volume—the "quota"—can be imported at the lower tariff, and imports in excess of the quota volume are charged the higher tariff.

TRQ's have existed for a long time, but their use has never been as widespread or important as standard import quotas and tariffs. The first one reportedly was a Belgian TRQ placed on cast iron from Luxembourg in 1839. TRQ's were briefly popular in Europe at the start of the global depression of the 1930's, but the severity of the crisis caused most TRQ's to be converted to simple quotas limiting the volume of permissible imports. By 1937, Switzerland was the only nation employing TRQ's on a wide scale, and after World War II, these TRQ's were abandoned for other trade barriers. In 1995, after more than 150 years of obscurity, over 1,300 TRQ's suddenly appeared, all for agricultural products (see sidebar). What brought this about?

One of the achievements of the last round of multilateral trade negotiations—the Uruguay Round in 1986-94, which created the World Trade Organization (WTO)—was the Agreement on Agriculture. While agriculture had been included in each of the previous rounds, it was not until the Uruguay Round that real progress was made in bringing new international discipline to trade and domestic policies related to agriculture and negotiating overall reductions in barriers to agricultural trade. Among its rules and disciplines, the Agreement on Agriculture includes a provision requiring the abolition of all "quantitative restrictions"—bans and quotas—on agricultural imports. But the provision allows members to convert existing quotas and bans into TRQ's. While this might seem contradictory, a TRQ, from a legal point of view, is not considered a quantitative restriction because it does not limit the quantity that may be imported. One may always import more by paying the higher, over-quota tariff. However, if a country sets the over-quota tariff high enough to deter importers from purchasing beyond the in-quota volume, a TRQ has the effect of a quota.

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At first glance, replacing quantitative restrictions with TRQ's does not appear to be a major accomplishment. But the Agreement on Agriculture includes a requirement that countries allow "minimum market access" for importation of commodities previously limited by quantitative restrictions as well as TRQ's to maintain access levels above the minimum market access levels. The general rule for "minimum market access" levels is that countries must provide the opportunity to import at the low-tariff rate a quantity equal to 3 percent of their domestic consumption of the commodity during 1986-88—the "base period" for the Agreement on Agriculture. These "minimum access TRQ's" became effective in 1995 and were increased by equal steps to reach 5 percent of base-period consumption in 2000.

TRQ's replacing quotas already set higher than minimum access quantities were not required to increase over time. For example, the U.S. imports far more than 5 percent of its 1986-88 domestic consumption of sugar; thus the in-quota volume of the U.S. sugar TRQ was not required to increase. The U.S. quota for peanuts, however, restricted imports to less than the minimum access quantity, so the peanut TRQ has expanded each year and now stands at 5 percent of 1986-88 consumption.

The provision that allowed TRQ's to replace former quantitative restrictions was critical to bringing the Uruguay Round to a successful conclusion. It allowed the transformation of quotas and other measures to be addressed for the first time, by providing incremental reform and increased market access. There was general recognition that the TRQ's would need to be addressed

Tariff Rates for Tariff-Rate Quotas Vary by Country

	Average tariff		Tariff on butter	
	Within-quota	Over-quota	Within-quota	Over-quota
	Percent			
South Korea	21	366	40	99
Japan	20	274	35	502
Canada	8	203	12	299
European Union	8	45	55	146
U.S.	10	29	8	96

Source: Agricultural Market Access Database (2000) (http://www.amad.org/).
Economic Research Service, USDA

again in future multilateral agricultural trade negotiations. New negotiations are here, and member countries are proposing ways to resolve many of these issues.

TRQ Negotiation Issues: Liberalization & Administration

Two kinds of TRQ issues must be addressed: TRQ liberalization and TRQ administration. ***Liberalization*** concerns changing the tariff and quota components of existing TRQ's. TRQ ***administration*** relates to how the importing country allocates the right to import at the in-quota, or lower, tariff rate. Proposals are under consideration to reduce in-quota and over-quota tariffs and to expand in-quota volumes. Questions about liberalization are likely to revolve around how and how much to reduce tariffs or increase TRQ access; whether certain types of TRQ's require special attention; and whether minimum-access TRQ's should be expanded.

Reducing certain prohibitive over-quota tariffs has the greatest potential for liberalizing trade. For example, over-quota tariffs for butter, a highly protected commodity, are often in the triple digits, compared with the average 3.9 percent tariff levied by developed countries on manufactured goods. Aggressive reduction of over-quota tariffs would allow over-quota imports to become economically viable.

Over-quota imports are not subject to in-quota administration rules, and thus are not limited to selected suppliers or restricted to narrow product specifications or end-uses. They provide greater market access and exert economic pressure for more transparent administration of in-quota imports and for adjustment in domestic markets as competing products are imported.

TRQ administration is likely to be an equally difficult issue. The General Agreement on Tariffs and Trade (GATT)—the international agreement that was incorporated into the WTO—has governed the administration of quantitative restrictions since 1947. Although these rules, still in effect, were drafted with quotas in mind, they also apply to TRQ's. The administration of over 1,300 new TRQ's since 1995 has resulted in widely varying interpretation of the rules, and this large gray area has led to a wide variety of disputes, some discussed below. Many WTO members are now proposing clarifications of existing rules or adoption of new disciplines.

TRQ administration is, basically, rationing. If demand for imports exceeds the volume allowed at the in-quota tariff, then the right to import at this level can be worth a great deal of money. A trader bringing in product under the first tier (in-quota rate) can buy at the world price, pay the low tariff, then sell at the higher—often much higher—domestic price. Opportunities for a guaranteed profit tend to attract more applicants (traders) than opportunities, so some method of allocating among applicants is required.

The World Trade Organization identifies seven principal methods of TRQ administration. Member nations must notify WTO about how they administer the TRQ's in their tariff schedules. In 1999 almost half the TRQ's notified were not enforced. Rather, all imports were allowed at the in-quota tariff—the applied tariff

TRQ's Are Concentrated in a Small Set of Countries & Commodities

At the end of 1999, 37 of the 137 WTO members had notified a total of 1,368 TRQ's to the WTO Secretariat. Three countries account for one-third of all TRQ's: Norway, Poland, and Iceland together have 431. TRQ's are also more often employed by developed industrialized countries than developing countries. Countries that have entered regional trade agreements often use TRQ's to "grandfather" a share of a market for a traditional supplier.

Country	No. of TRQ's
Norway	232
Poland	109
Iceland	90
EU	87
Bulgaria	73
Hungary	70
Colombia	67
S. Korea	64
Venezuela	61
U.S.	54
Other	461
Total	1,368

Commodity	No. of TRQ's
Fruit & vegetables	354
Meat	245
Cereals	217
Dairy	181
Oilseeds	124
Coffee, tea, etc.	56
Sugar	51
Beverages	35
Eggs	21
Fibers	18
Tobacco	13
Other	53
Total	1,368

TRQ'S notified to WTO for 1999. A TRQ (tariff-rate quota) is a two-tiered tariff. A limited volume (the "quota") can be imported at the lower tariff, and imports in excess of the quota volume are charged the higher tariff.
Source: World Trade Organization (2000).

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Method of TRQ administration	Explanation	Share of all 1999 TRQ's
Applied tariff	Unlimited imports are allowed at or below the in-quota tariff rate; that is, the quota is not enforced.	47%
License on demand	Licenses are required in order to import at the in-quota tariff. If demand for licenses is less than the quota, the system operates on a first-come, first-served basis. If demand exceeds quota, the import volume requested is reduced proportionately among all applicants (traders).	25%
First-come, first-served	Imports are charged the in-quota tariff until the quota is filled; all subsequent imports are charged the over-quota tariff.	11%
Historical	The right to import in-quota tariff is allocated in proportion to import market shares in a base period.	5%
Auction	The right to import at the in-quota tariff is auctioned.	4%
State trader or producer group	The right to import in-quota is granted wholly or primarily to a state trading organization or an organization representing domestic producers of the controlled product.	2%
Mixed	Two or more of the methods above are combined.	4%
Other or not specified	The methods used do not correspond to the methods above nor are they specified in WTO notifications.	2%

Source: World Trade Organization.

method. The over-quota tariff may be re-applied at will, however. Of the TRQ's enforced, license on demand and first-come, first-served are the two most common means of allocating access at the in-quota tariff. Less common methods are auctioning and allocations based on market shares in some earlier period—the 'historical' method. Different allocation methods may lead to the same volume of in-quota imports but very different exporter market shares. Trade disputes can emerge over how the in-quota pie is sliced.

The common-sense notion of mandating minimum market access is that domestic consumers would then have at least a limited opportunity to choose between domestic products and imported products. Such competition would expand consumer choice, reduce domestic prices, however slightly, as supplies expand, and perhaps cause the domestic industry to begin to adjust to international market forces. This is a generous and broad interpretation of market access—the spirit of the law. But countries "forced" to open their markets can minimize the impact of imports while meeting the letter of the law, and many have been very creative in this endeavor.

Insulating Domestic Markets & Biasing Trade Flows

The minimum access provisions under the Agreement on Agriculture were anticipated to have their greatest impact in markets that had been insulated from international trade, but this has not happened in several cases. For example, prior to 1995, Japan had maintained a complete ban on rice imports; the Agreement on Agriculture requires that it allow minimum market access (in-quota amounts) to rice exporters. Though Japan has followed the letter of the law and imported the required minimum amounts, Japanese consumers have eaten very few kernels of foreign rice. A large proportion of the imported rice remains in storage and is not available to domestic buyers; most of the remainder is channeled to processors for production of rice wine and rice cakes. Very little imported japonica rice, such as that produced in California, can be found on supermarket shelves in direct competition with domestic Japanese rice (*AO* April 1999).

In South Korea, the rice TRQ is limited to brown rice. The TRQ is filled by accepting the lowest priced tenders, with little regard to quality. The imported brown rice is then strictly channeled to processors because the government imposes substantial fines for diverting rice into higher valued end uses. Hungary employs the same technique with its beef TRQ—all in-quota beef imports are restricted to processing use. In each case, the government denies the domestic consumer direct access to the imported products.

To minimize the impact on the domestic market, Japan and South Korea directly control the processes though which rice imports are procured. However, there are other means of managing in-quota imports that can bias, intentionally or inadvertently, the market shares of competing suppliers.

For example, Poland in 1999, issued permits to traders for importing within its wheat TRQ; the maximum quantity allowed per permit was 5,000 tons. In early 2000, this maximum was reduced to 1,500 tons and its validity limited to 1 month from the date of issue. The small permit quantity and short delivery window favored rail shipments from the EU and neighboring Central Europe, and effectively prohibited imports by ship from Argentina, Australia, Canada, or the U.S. In part because of a poor harvest this summer, the permit volume has recently been increased to 25,000 tons and the delivery window raised to 2 months.

Additional regulations can also bias the kind of product that can be imported in-quota. In 1997, the U.S. initiated a complaint against Canada's fluid milk TRQ. Canada officially allows the annual import of 64,500 tons of fluid milk at the in-quota rate of 7.53 percent; over-quota imports face a 241.3-percent tariff. Canada's tariff schedule notes that "This quantity represents the estimated annual cross-border purchases imported by Canadian consumers." Canada administers the TRQ by *not* administering it: It allows individual Canadian residents to enter Canada with fluid milk for their personal use as long as no more than Can$20 of fluid milk enters in a single shopping trip. There are no permits or licenses, the in-quota tariff is not charged, and no record is kept of the volume of fluid milk imports.

The U.S. complaint to the WTO argued that restricting imports to less than Can$20 per shipment discriminates against, and in effect prohibits, commercial shipments of fluid milk. The WTO dispute panel determined that Canada's $20 limitation is inconsistent with Canada's WTO minimum access commitments. However, it also determined that Canada is not obliged to allow bulk shipments of fluid milk to satisfy the in-quota volume of the TRQ. So, Canada can still restrict in-quota imports to fluid milk for personal use, but it can no longer limit them to less than $20 Canadian per entry.

The domestic purchase requirement is another questionable TRQ licensing provision that unnecessarily inhibits imports. Under such a provision, an importer must purchase a certain amount of domestically produced product in order to import a specified amount of the product. For example, Venezuela requires evidence of domestic purchase before it will issue a license for in-quota dairy product imports; Switzerland has domestic purchase requirements for some dairy products, shell eggs, seed potatoes, cut flowers, and various types of fresh fruit and live animals; and Colombia has 33 TRQ's with domestic purchase requirements, primarily for grains and oilseeds and their processed by-products.

What Can Be Done About TRQ's?

Because most existing TRQ's were first imposed in 1995, the implementation period for the Agreement on Agriculture (1995–2000) can be viewed as a trial period for TRQ's. Trade negotiators are returning to the table with over 5 years of experience in administering their own TRQ's and/or contending with those of their trading partners. Many of the problems, such of those discussed in this article, are widely recognized, and preliminary negotiation proposals indicate a general interest in addressing them.

Negotiations can create new policies or strengthen existing disciplines for liberalization and administration. New policies on liberalization and administration may prove difficult to introduce, but much can be accomplished by enforcing or clarifying existing ones. Observers will likely witness some of both in the upcoming WTO agricultural negotiations. AO

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Related Reading

WTO Briefing Room on the Economic Research Service Web site. <http://www.ers.usda.gov/briefing/wto/.

"China's WTO Accession Would Boost U.S. Ag Exports & Farm Income," *AO* March 2000 (includes discussion of China's TRQ's and state trading). <http://www.ers.usda.gov/epubs/pdf/agout/mar2000/ao269e.pdf>

Agriculture in the New WTO Round: Options for Policy Reform, Economic Research Service. (forthcoming)

The Economics of TRQ Administration, Technical Bulletin, Economic Research Service. (forthcoming)

World Trade Organization, "Tariff Quota Administration Methods and Tariff Quota Fill: Background Paper by the Secretariat." 26 May 2000. G/AG/NG/S/8

http://www.wto.org/ddf/ep/E2/E2153e.doc